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It may end up better to jettison the whole SALT apparatus and settle for the standard deduction.

Taxpayers Should Beware the Costly SALT Cap Phaseout Zone

By Philip DeMuth

Right now, people making more than \$500,000 a year are sitting pretty. They are in the 32% federal tax bracket and probably loaded with mortgage interest. They pay an abundance of state and local taxes, and they might even make a few donations to charity. Excited to finally itemize \$40,000 of their state and local taxes for a fat tax deduction, they fail to spot the trouble ahead.

Trouble is coming, however, and it lies in the SALT Cap Phaseout Zone. The problem arises when the effective marginal tax rate on their next dollar of income increases from 32% to 41.6%, which they will discover next April. Here's how this happened.

High-earning residents of New York, New Jersey, California and other high-tax locales are tempted to cheer now that Congress has raised the cap on state and local tax deductions. Ever since the Tax Cuts and Jobs Act capped these deductions at \$10,000 during President Trump's first term, politicians from high-tax states have fought to undo it.

They've now achieved a partial victory: The One Big Beautiful Bill Act raises the cap to \$40,000—at least temporarily. But hold the champagne. This relief comes with a hidden tax hike.

When the federal income tax began in 1913, state and local taxes were deductible to an unlimited extent. But by 1969 the dreaded Alternative Minimum Tax was instituted, offering no SALT deduction at all. That was followed in 1991 by the Pease limitation, which clawed back up to 80% of every itemized deduction. The 2017 tax cuts swapped these back door erosions for a simple front door \$10,000 SALT ceiling.

The SALT deduction gave states an excuse to spend recklessly. The net effect was that conservatively managed, low-tax central states had their federal tax dollars forwarded from Washington to their high-taxing, free-spending liberal cousins on the coasts. In effect, middle-class workers in Texas and Oklahoma pitched in to help pay the state taxes for millionaires in Massachusetts and New Jersey.

Robbing the poor to pay the rich is bad tax policy. So is subsidizing waste and extravagance. When Congress capped SALT deductions at \$10,000 in 2017, these high-tax states were disgruntled. They tried to sidestep the problem by letting their taxpayers donate to special state funds and receive a federal charitable deduction in exchange. In 2019 the Internal Revenue Service disqualified these "charities" from the federal deduction.

Affluent blue-state taxpayers were left carrying the weight of their state and local taxes. Never mind that they were only losing a subsidy that others never enjoyed. Few of those looking to the One Big Beautiful Bill for deliverance are from states with even one Republican senator.

The Constitution says tax laws begin in the House. To pass the One Big Beautiful Bill Act, the Senate had to contend with the House's plan,

which permanently raised the cap on state and local taxes from \$10,000 to \$40,000. Shedding no tears, the Senate snapped the deduction back to \$10,000 at the end of 2029, booking a projected savings of \$50 billion to \$80 billion to grease the reconciliation process. Sometimes it pays to vote Republican.

The new \$40,000 cap is available to people in the lower tax brackets when they don't need it, while remaining unobtainable to those in the highest brackets when they could really use it. The people with income in between have been selected for special punishment: a 9.6% surtax on income from \$500,000 to \$600,000.

That is the range where every additional dollar starts by getting taxed at the normal 32% bracket rate, but now simultaneously triggers a 30% SALT cap phaseout. This means 30 cents of a previously shielded dollar will also be shaken down by 32%, for an additional 9.6% tax on that dollar. If you started in the 32% bracket, your effective marginal rate becomes 41.6%.

If that sounds bad, brace yourself: The SALT cap phaseout will push you into the 35% bracket \$10,000 to \$15,000 sooner than you expected, while lifting your marginal rate to 45.5%. Depending on your particular cocktail of itemized deductions, a point may come when it is better to jettison the whole SALT apparatus and settle for the standard deduction.

There isn't much time to prepare. Unlike most sensible tax provisions that give you a year to get ready, this one begins in tax year 2025. You might already be destined for the SALT Cap Phaseout Zone and not even know it.

It all depends on your Modified Adjusted Gross Income, which for this section of the bill is your vanilla Adjusted Gross Income after adding back any esoteric foreign income exclusions under §§ 911, 931 or 933. Unless your situation is unusual, your MAGI will equal your AGI. For context, check your AGI in 2024 (Form 1040, Line 11). A chinwag with your accountant might be in order well before the ball drops on 2025.

Mr. DeMuth is author of "The Tax-Smart Donor: Optimize Your Lifetime Giving Plan."

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